

# Weighing "Good Will's" Value

By GEORGE BROKAW COMPTON.

WHEN a wealthy New Yorker died recently after amassing a fortune, due partly to his own efforts but to a greater extent to the reputation built up by his business through many years, there was general speculation in stores and offices as to the manner in which the valuation for his interest in the good will of his business would be fixed. The general lack of familiarity with the subject, not only on the part of business men but also of many lawyers engaged in trying to solve the complex questions, caused me to make a new study of recent court decisions on the much discussed point of how to determine the value of an unlisted security, which means one having no definite rating on a stock exchange, or how to fix the good will value of an interest in a successful partnership.

This study developed an interesting line of authorities bearing on the estates of both business and professional men, which must be considered eventually by the taxing officials in fixing good will values. Lawrence W. Scudder, C. P. A., a specialist in the appraisal of securities, and I have joined forces for the purpose of preparing a book which may help to clear away the difficulties surrounding the subject of good will valuation, and I present herewith briefly a part result of our collaboration which shows that the potentiality of "growing rich beyond the dreams of avarice" is not an altogether extravagant description of good will and the part played by it in building up fortunes.

Not only are the court decisions reviewed for this purpose full of human interest but they also reveal the judicial basis which has been adopted for estimating the value of an intangible asset regarding the precise nature of which most people have only a vague conception. Even the courts find good will baffling, for they have said there is no object more difficult to value.

But it is worth money. Through an increased value of corporate stock or of a partnership interest or of the business of an individual proprietor, good will frequently makes its possessors rich. Not until a business is sold, however, or until occasion arises to value a part interest, or until an appraisal is necessary in an inheritance or other tax proceeding, is it usually realized what an important factor that "intangible something" has been in making a fortune. This is particularly true with respect to many New York merchants, who are literally good will millionaires. In numerous cases good will has been the one factor which enabled them to make profits while their competitors were suffering losses. Nevertheless, to define it has proven a troublesome judicial task.

Courts have defined good will in many and varied ways. Lord Elton, England's famous authority, describes it simply as "The probability that the old customers will resort to the old place," while Judge Story of New York says, "Good will may be properly enough described to be the advantage or benefit which is acquired by an establishment, beyond the mere value of the capital stock, funds or property employed therein. In consequence of the general public patronage and encouragement which it receives from constant or habitual customers on account of its local position or common celebrity or reputation for skill, or influence, or punctuality; or from other accidental circumstances or necessities, or even from ancient partialities or prejudices." The business man's conception of the value of good will in any particular case is the amount which he would be willing to pay solely for the privilege of continuing an established business. Good will in a business does not appear among its tangible assets, yet is an essential factor in producing its earnings. The value of the good will of a particular business may be described as that amount which it is necessary to add to the agreed value of its tangible assets to give a sum equal to the price which a willing buyer would pay for it as a going concern.

No matter how defined, good will has become a commodity. Although in the nature of things it cannot endure apart from a business, it is bought and sold every day along with other business assets. It can be accumulated, like any other form of wealth, and left to one's heirs. Since it is a form of property, the State has de-

clared it to be subject to taxation. For this reason the courts have set for themselves methods of determining its value in dollars and cents.

## "Good Will" in Franklin Simon Case.

An interesting case involving the valuation of good will arose in the transfer tax appraisal of the net worth of the dry goods business of Franklin Simon & Co., a partnership, after the death in August, 1914, of Herman Flurschheim, equal partner with Franklin Simon. The tax appraiser valued his interest in the firm of approximately \$900,000, of which amount two-thirds represented the interest of the deceased in the tangible assets and one-third his interest in the good will. The State Comptroller appealed from the order assessing the inheritance tax on this basis. The appeal was sustained, and Surrogate Fowler, in remitting the report of the appraiser for revision, said "Franklin Simon & Co. was established in the year 1903 with a combined capital of \$110,000. Three elements must be considered in the determination of good will—net profits, capital and the number of years' purchase."

By the phrase "number of years' purchase," the courts mean simply a multiple. This "multiple" or number times the average annual net profits is held to equal the amount a purchaser would be willing to pay solely for the advantage of continuing the business. The expression "number of years' purchase" was taken over from the old English decisions by the American courts when they first began to value good will.

How a court reasons in the process of deciding the "number of years' purchase" to be used in a particular case is illustrated by this further quotation from the Surrogate's opinion in the matter of Flurschheim:

"The transfer tax appraiser has applied a multiple of three years to the sum ascertained by deducting from the net profits as found by him 6 per cent. interest on the capital and \$100,000—representing the value of the services of the decedent and the surviving partner, to which latter item no objection is made and the amount appears to the court reasonable and proper. The sole reason assigned by the accountant and adopted by the transfer tax appraiser for not applying a larger multiple is because the firm was in existence at the death of the decedent only twelve and one-half years. I do not think that this is a controlling factor. The record shows that the sales have increased steadily since the establishment of the copartnership. The sales for the three complete fiscal years preceding decedent's death were respectively \$3,986,859, \$5,003,364 and \$5,919,925. In the year prior to the death of decedent \$219,858.82 was the sum spent for advertising. The firm is extremely well and favorably known. It has succeeded in establishing a reputation in the community which might not be gained by other concerns in business many years longer. Under all the circumstances I think a five years' purchase should be applied in fixing the good will."

Thus the value of the interest of the deceased in the copartnership was determined by computing the average net annual profits for the three complete fiscal years preceding his death. After deducting therefrom 6 per cent. on the average annual net tangible capital and surplus employed for the same period, and a total of \$100,000, as the reasonable annual value of the services of the two partners, the difference multiplied by five, or about \$1,200,000, was held by the court to be the value of the good will.

Starting business in 1903 with a capital of about \$100,000, this firm had acquired twelve and one-half years later a good will conservatively estimated by the court to be worth in excess of \$1,000,000. Solely by this accumulation of good will, \$100,000 was added each year to the assets of the firm and the value of its business.

## Why Tiffany Stock Went Up.

That the value of the stock of a corporation, in the opinion of the courts, is based on good will as well as upon more tangible assets, such, for instance, as diamonds, was shown when Charles M. Moore died owning fifty shares of Tiffany & Co.'s stock which was appraised for inheritance tax purposes. The par value of this stock was \$1,000 per share. The appraiser re-

ported its market value per share at the date of decedent's death to be \$7,683.45.

In reviewing this valuation, the Surrogate said:

"The appraiser ascertained the value of the good will by deducting interest at the rate of 6 per cent. per annum on the capital employed by the company in its business and multiplying the difference by ten. This gave the value of the good will as \$1,507,922.40. No exception was taken to the amount which the appraiser adopted as the average annual net profits, but it is contended that the value of the good will should be ascertained by multiplying the average net profits by three or five instead of ten, the latter being the figure used by the appraiser."

The Surrogate then pointed out that the cases in this country are not uniform in regard to the "number of years' purchase" to be used and that most of the American cases adopt a period ranging from two to six years, the number being dependent upon the nature of the business, the length of time during which it has been established at a particular place and the extent to which it is known to the public.

"Tiffany & Co.," he said, "has an enviable international reputation as a craftsman and tradesman; it has been established in New York City for more than sixty years. If six years' purchase of the average annual net profits was considered not an unreasonable value of the good will in a case where the question of good will related to the name under which a number of candy stores were conducted, it would seem that the good will of a company having the prominence, the permanency and the established reputation of Tiffany & Co. should be worth at least ten years' purchase of the annual net profits. It seems to me, therefore, that the finding of the appraiser was not against the weight of evidence and was not so manifestly incorrect as would warrant the court in modifying or rejecting it."

## Variations Many—Even Professions Included.

In the transfer tax appraisal of the estate of George A. Hearn, the good will of the dry goods firm of James A. Hearn & Son, which was established in West Fourteenth street, New York city, in 1879, was valued at more than twice the value of its tangible assets. The number of years' purchase used was five. "In view of the length of time during which the business has been established, its reputation, its extensive advertising and its prominence in the dry goods trade," the court said, "I think five years' average of the annual net profits is a reasonable value of the good will of the business."

As contrasted with these examples of good will in business enterprises, it appears that while good will can be acquired by a doctor, a lawyer or other professional man during his life time, as well as by a business man, the good will built up by the doctor, unlike that built up by the business man, died with him.

Dr. Eugene Wilson Caldwell left the good will of his medical practice, together with the apparatus used in connection therewith, to his two assistants, and the transfer tax appraiser valued his good will at a large amount. The executors of his will contended that the business had no good will which survived him and appealed from the order assessing the tax.

The deceased had been a physician, but he specialized in the taking of X-ray photographs for medical purposes. He was one of the pioneers in the use of X-ray apparatus in the diagnosis of disease. He invented and perfected many improvements in the mechanical appliances and chemical processes used in X-ray photography and acquired great proficiency in the art. For these reasons and because he lectured on the subject before many medical societies and scientific bodies, he became known to the medical profession of New York and the adjacent country as an expert of great knowledge and skill.

It was found by the court that the extensive and lucrative business transacted by the deceased was the direct result of his reputation for great skill in taking X-ray pictures. As this skill and knowledge died with him, it could not constitute an element of good will that would survive him. Because of his prominence and reputation as a roentgenologist his death

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